annexation . . . notwithstanding the provisions of any other law."[70] The appellants contended that the statute unconstitutionally vested legislative power in the courts by permitting discretionary control over municipal action. The court rejected appellant's argument and held that the statute did not vest legislative power in the courts but, rather, authorized the courts to determine whether the city had complied with all the statutory requirements for annexation.

Although the statute provides that courts "may" order annexation, it was given a mandatory construction. The court of appeals reasoned that, although "may" normally implies discretion, it will be construed to mean "shall" when its ordinary meaning would defeat the objective of the statute and the intent of the legislature. Thus, if the court finds compliance with the annexation statute, it must order the annexation.[71]

III. Business Associations

*Paul J. Galanti**

The following survey of developments in the corporate area during the past year should be considered an overview rather than an extensive analysis.[1]

A. Securities Fraud

A somewhat unusual securities fraud case was before the First District Court of Appeals in *Soft Water Utilities, Inc. v. LeFevre.*[2] The court affirmed a judgment for plaintiff entered by the Putnam County Circuit Court. The suit arose out of LeFevre's April 8, 1959, purchase of 2,080 shares of what he believed was a new issue of 50,000 common shares of Soft Water Utilities [SWU]. In fact,

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[70] IND. CODE § 18-5-10-25 (IND. ANN. STAT. § 48-722, Burns Supp. 1974) (emphasis added).

[71] 297 N.E.2d at 919.

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The author wishes to express his appreciation to Thomas J. Blee for his assistance in preparing this survey of corporate developments.

[1] A case worth noting in passing is Lindenborg v. M & L Builders & Brokers, Inc., 302 N.E.2d 816 (Ind. Ct. App. 1973), in which the court restated the well established principle that changing the name of a corporation does not affect its liability for indebtedness previously incurred. *See, e.g.*, Rice v. Fletcher Savings & Trust Co., 215 Ind. 698, 22 N.E.2d 809 (1939).

[2] 308 N.E.2d 395 (Ind. Ct. App. 1974) (Robertson, J.).

they were previously issued shares that had been purchased by defendant Farrell, a licensed stockbroker employed by SWU as a selling agent for the new issue. The actual sale was made by Farrell's employee, Hurst. A prospectus covering the issue had been prepared and registered with the Indiana Securities Commissioner under the Indiana Securities Law in effect in 1959.[3] The prospectus contained a balance sheet showing the net worth of the corporation as $343,690.85. This figure would have been increased by approximately $250,000 if the entire issue had been sold at the asking price of $5 a share.

An intriguing aspect of the case is that it was not based on the civil remedy provided in the then effective Securities Law. That remedy was rescission of the transaction by the purchaser.[4] Rather, LeFevre's suit was for damages for common law fraud. The decision does not explain his rationale, but presumably he was motivated by the two year statute of limitations applicable to rescission actions.[5] The appellate court held that rescission was not the exclusive remedy available to purchasers since the statute specifically provided that "the rights and remedies provided by this act shall be in addition to any and all other rights and remedies that may exist at law or in equity."[6]

Thus, the key to the *LeFevre* case was whether plaintiff had established the four essential elements of common law fraud: material misrepresentations, scienter, reliance by plaintiff, and injury.[7] Central to the misrepresentation element was the evidence that Farrell had "made a market" in SWU stock by trading approximately

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[3]Ch. 120, §§ 1-25, [1937] Ind. Acts 656 (repealed 1961); ch. 30, §§ 1-12, [1941] Ind. Acts 71 (repealed 1961); ch. 35, §§ 1-4, [1947] Ind. Acts 98 (repealed 1961); ch. 239, § 1, [1949] Ind. Acts 791 (repealed 1961); ch. 194, §§ 1-3, [1951] Ind. Acts 526 (repealed 1961); ch. 127, § 1, [1953] Ind. Acts 438 (repealed 1961); ch. 290, § 1, [1955] Ind. Acts 829 (repealed 1961); ch. 224, § 1, [1959] Ind. Acts 536 (repealed 1961).

[4]Ch. 120, § 19, [1937] Ind. Acts 656 (repealed 1961). This provision contrasts with the civil penalty section of the current Securities Law, IND. CODE § 23-2-1-19(a)(1)-(2) (Burns 1972), which provides for rescission or damages in the event the purchaser no longer owns the security sold in violation of the Act.

[5]Ch. 120, § 19, [1937] Ind. Acts 656 (repealed 1961).

[6]Ch. 120, § 22, [1937] Ind. Acts 656 (repealed 1960). The saving clause in the current statute, adopted in 1961, provides that a right of action conferred by the prior law is not impaired or abrogated by its repeal. IND. CODE § 23-2-1-23 (Burns 1972).

[7]Edwards v. Hudson, 214 Ind. 120, 122, 14 N.E.2d 705, 706 (1938); Middlekamp v. Hanewich, 147 Ind. App. 561, 566, 263 N.E.2d 189, 192 (1970); Farm Bureau Mut. Ins. Co. v. Seal, 134 Ind. App. 269, 277, 179 N.E.2d 760, 763 (1962). For a general discussion of common law fraud, see W. PROSSER, LAW OF TORTS §§ 105-10 (4th ed. 1971) [hereinafter cited as PROSSER]; RESTATEMENT OF TORTS §§ 525-49 (1938).

17,000 previously issued shares. He apparently followed the "classic" investment advice of buying low at $2 to $4 a share, and selling high at $5 per share as specified in the prospectus for the new issue. Hurst's specific misrepresentations were flagrant and apparent. LeFevre was told that the new issue of 50,000 shares was almost sold out, whereas in fact only 1,089 shares were ever sold. LeFevre was led to believe he was buying the new issue whereas in fact he was buying stock owned by Farrell. Hurst told LeFevre that the funds obtained through the sale would go to the corporate treasury, but the $10,400 paid for the stock apparently went to Farrell rather than to the corporation. If most of the new issue had been sold and the proceeds received by SWU, its net worth would have been augmented by approximately $250,000 less the broker's fee owed Farrell, which was far more than the approximately $5,500 actually received. The court concluded that the fact that the "misrepresentations were material cannot be seriously contested."[8]

SWU contended that no false representations were made because the transaction had shifted from the new to the prior stock when LeFevre disclosed that he did not have the necessary cash, as required by the prospectus, to buy the new stock. LeFevre instead offered Hurst 1,000 shares of another company in exchange for the SWU stock. Farrell eventually approved the deal and credited LeFevre with $10,000. SWU argued that LeFevre, as an experienced investor, must have known that the subject matter of the transaction had changed; ergo, no false representations had been made. LeFevre responded that it was his understanding that Farrell would either sell the stock on the open market or buy it himself and use the proceeds to purchase the new issue SWU shares. The trial court accepted LeFevre's understanding of the transaction and the appellate court concluded the finding was adequately supported by the record.

The court next considered the scienter, or guilty knowledge, element of the fraud action. The court acknowledged that Hurst might not have been aware of the falsity of his representations, but considered this irrelevant since Hurst received his information and instructions from Farrell and since the evidence was such that scienter readily could be inferred to Farrell.[9] The court categorically

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[8]308 N.E.2d at 397.

[9]The evidence indicated that, as SWU's exclusive agent for selling the new issue, Farrell had convinced the board of directors that it was necessary for him to trade in the previously issued stock. Since he bought and sold approximately 17,000 old shares, while selling only 1,089 new shares, the trial court was correct in concluding that previously issued stock was being sold as new and that Farrell was aware of the false representations being made by Hurst in furthering the fraudulent scheme. *Id.* at 398.

rejected SWU's suggestion that scienter and the other elements of the fraud cause of action cannot be established by inference. The law in this respect is well settled. Positive evidence of fraud is not required and it is sufficient if a plaintiff proves facts and circumstances from which fraud fairly can be inferred.[10]

The deception and reliance element was satisfied by LeFevre's showing that he reasonably relied on the SWU prospectus which referred only to the new issue stock; further, his questions concerning SWU's use of the proceeds showed sufficient care and diligence in guarding against fraud since the answers did not put him on notice to investigate further. As the court stated, "a person has a right to rely upon representations where the exercise of reasonable prudence does not dictate otherwise."[11] This is particularly true when the statements are not obviously false on their face or when, as here, the facts are peculiarly within the knowledge of the seller.[12] The injury element was satisfied by the trial court's finding that LeFevre had paid $10,400 for an interest in a corporation which had a net worth substantially less than the value represented. Since SWU had not received the proceeds from LeFevre's purchase nor from any of the other supposed sales of the new issue stock, its prospects for future growth and increased profits were considerably diminished.

All of this only established that Farrell had committed fraud. To recover against SWU, LeFevre had to establish an agency or conspiracy relationship between Farrell and the corporation. The court of appeals concluded that an agency relationship had been established. Farrell had been employed by SWU for the purpose of selling the new issue of stock. This at least clothed Farrell, and his employee Hurst, with the apparent authority to make representations on behalf of the principal, SWU. Basic to the concept of apparent authority is the principal's *manifestation* to the third party that the agent is authorized to negotiate or make representations on the principal's behalf.[13] This "holding out" element was

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[10]*See* Grissom v. Moran, 290 N.E.2d 119, 123 (Ind. Ct. App. 1972); Edwards v. Hudson, 214 Ind. 120, 122, 14 N.E.2d 705, 706 (1938); Middlekamp v. Hanewich, 147 Ind. App. 561, 566, 263 N.E.2d 189, 192 (1970).

[11]308 N.E.2d at 398. *See* Grissom v. Moran, 290 N.E.2d 119, 124 (Ind. Ct. App. 1972); Voorhees v. Cragun, 61 Ind. App. 690, 700, 112 N.E. 826, 829 (1916).

[12]*See* Grissom v. Moran, 290 N.E.2d 119, 124 n.10 (Ind. Ct. App. 1972); Kluge v. Ries, 66 Ind. App. 610, 117 N.E. 262 (1917). *See generally* PROSSER § 108, at 715-18; *cf.* RESTATEMENT (SECOND) OF AGENCY § 171 (1958).

[13]*See* Gizzi v. Texaco, Inc., 437 F.2d 308 (3d Cir. 1971); Storm v. Marsischke, 304 N.E.2d 840, 842 (Ind. Ct. App. 1973) (discussed at text accompanying notes 103-13 *infra*); Farm Bureau Mut. Ins. Co. v. Coffin, 136 Ind. App. 12, 17-18, 186 N.E.2d 180, 183 (1962). *See generally* RESTATEMENT (SECOND) OF

satisfied in *LeFevre* by the statement in the prospectus that Farrell had the exclusive contract to sell the new issue.[14]

Although not all authorities agree,[15] the *LeFevre* court adopted the position of the *Restatement (Second) of Agency* that an entirely innocent principal who puts an agent in a position to commit fraud while apparently acting within his authority is liable for the fraud.[16] The comments to the relevant section of the *Restatement* emphasize that it was the principal who placed the agent in the position to consummate the fraud and that, from the point of view of the third person, the transaction would seem regular on its face. It is irrelevant that the principal is innocent and might not have received the benefits of the fraud. Of course, there is no question of liability if the principal is involved in the fraud.[17] Since the *LeFevre* court found apparent authority, it did not consider whether Farrell or Hurst had actual authority to make the representations in question.

At this point, the appellate court differed with the trial court's conclusion that Farrell and SWU had conspired to defraud LeFevre. There is authority that, under extraordinary circumstances, a corporation can conspire with its officers or independent agents,[18] but the general rule is that a corporation and its agents acting within the scope of their authority are one entity and hence cannot conspire.[19] The court concluded that the *LeFevre* case was within the

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AGENCY §§ 8, 27 (1958); W. SEAVEY, LAW OF AGENCY § 8D (1964) [hereinafter cited as SEAVEY].

[14]308 N.E.2d at 399.

[15]*See, e.g.*, Mills v. Lewis Wood Preserving Co., 93 Ga. App. 398, 91 S.E.2d 785 (1956); Mesce v. Automobile Ass'n, 8 N.J. Super. 130, 135-36, 73 A.2d 586, 588-89 (App. Div. 1950).

[16]RESTATEMENT (SECOND) OF AGENCY § 261, comment *a* at 570-71 (1958). *See* Bowman v. Home Life Ins. Co., 243 F.2d 331 (3d Cir. 1957); Old Line Auto. Insurors Co. v. Kuehl, 127 Ind. App. 445, 451-52, 141 N.E.2d 858, 861 (1957). *See generally* RESTATEMENT (SECOND) OF AGENCY §§ 257-58, 264-65 (1958); SEAVEY §§ 60, 61, 92.

[17]Dellefield v. Blockdel Realty Co., 128 F.2d 85, 91 (2d Cir. 1942); Ashby v. Peters, 128 Neb. 338, 258 N.W. 639 (1935). *See generally* RESTATEMENT (SECOND) OF AGENCY § 257 (1958); SEAVEY § 92C.

[18]*See*, e.g., Albrecht v. Herald Co., 390 U.S. 145 (1968); Poller v. Columbia Broadcasting System, Inc., 368 U.S. 464, 469-70 (1962); Tamaron Distrib. Corp. v. Weiner, 418 F.2d 137 (7th Cir. 1969).

[19]The court cited Johnston v. Baker, 445 F.2d 424 (3d Cir. 1971); Pearson v. Youngstown Sheet & Tube Co., 332 F.2d 439 (7th Cir. 1964); and the leading case on point, Nelson Radio & Supply Co. v. Motorola, 200 F.2d 911 (5th Cir. 1952), *cert. denied*, 345 U.S. 925 (1953). The *Nelson* court drolly commented that the president, sales manager and other officers and employees of Motorola were "certainly a unique group of conspirators." 200 F.2d at 914. *See also* Goldlawr v. Shubert, 276 F.2d 614 (3d Cir. 1960); Johnny Maddox Motor Co. v. Ford Motor Co., 202 F. Supp. 103 (W.D. Tex. 1960).

general rule rather than the exception. One of the cases cited by the court was *Johnston v. Baker*,[20] wherein the Court of Appeals for the Third Circuit, recognizing that normally a corporation cannot conspire with its agents, nonetheless concluded that the fact of agency alone will not preclude a finding of conspiracy when there is evidence that the conspirators were acting for their personal interests and at least one of the parties to the conspiracy was not an employee or agent "as such" of the corporation. Perhaps Hurst, who was at best a sub-agent of SWU, fell into that category and even Farrell might have been sufficiently independent as a broker to satisfy the requirement. Certainly Farrell was not acting solely in SWU's interests. The *Johnston* court declined to rule whether the personal interests of a conspirator alone would sustain a conspiracy charge without a non-employee or non-agent defendant but intimated that it might so rule in an appropriate case.[21] Although it is possible that the *LeFevre* court erred on the conspiracy issue, agreement with the trial court would only have been an additional ground for affirming a judgment which would stand, in any event, on the agency showing.[22]

B. *Indiana Securities Law Exemptions*

The consequences of not complying with the registration requirements of the Indiana Securities Law[23] were amply demonstrated in *Hippensteel v. Karol*,[24] in which the Third District Court of Appeals reversed the Allen County Superior Court and instructed it to enter judgment for plaintiff Hippensteel. *Hippensteel* was a case of first impression in Indiana and presents some interesting problems for private individuals, as opposed to brokers or issuers, who sell securities. The case arose when defendant Karol, a doctor, sold securities of Ingenio La Gartia, a Costa Rican sugar refinery, to nine of his professional associates and colleagues. The securities were not registered with the Indiana Securities Commissioner.[25]

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[20]445 F.2d 424 (3d Cir. 1971). The judgment for plaintiff was affirmed in this action against the owner and the president of a hotel corporation alleging a conspiracy to injure plaintiff's business.

[21]*Id.* at 427.

[22]The court also rejected SWU's contention that it was error for the trial court to award prejudgment interest. The court concluded that LeFevre's damages, determined to be $6,644, were ascertainable at the time of the sale and that interest in such a case is appropriate. New York, C. & St. L. Ry. v. Roper, 176 Ind. 497, 503-04, 96 N.E. 468, 472 (1911).

[23]IND. CODE §§ 23-2-1-1 to -25 (Burns 1972).

[24]304 N.E.2d 796 (Ind. Ct. App. 1973) (Staton, J.).

[25]The registration provision of the Indiana Securities Law, IND. CODE § 23-2-1-3 (Burns 1972), is as follows:

It is unlawful for any person to offer or sell any security in this

They were sold in units of one share of stock and a debenture at $6,000 a unit. The transaction with Hippensteel was the last of the nine.

Karol's involvement with Ingenio La Gartia began when he purchased twenty units for $120,000. After attending a shareholders meeting in January, 1967, he decided to sell eighteen of the twenty units at his original cost of $108,000. The opinion does not indicate if Karol became soured on the investment at the meeting. Subsequent to the sales, he came under pressure from the management and other shareholders of the Costa Rican company to reinvest. He did reinvest in May, 1967, when he purchased eight additional units of the unregistered securities. Either he still had some doubts about the company or he actually was in the securities business because, in July, 1967, he sold five units to Hippensteel for an agreed price of $30,000. When it became apparent to Hippensteel, within the two year statute of limitations,[26] that the company might be in financial difficulty, he filed his complaint alleging that (1) the sale of the securities was fraudulent at common law and violated the fraudulent practices provision of the Securities Law,[27]

> state unless (1) it is registered under this act or (2) the security or transaction is exempted under section 102 [*Id.* § 23-2-1-2].

The statute provides two methods of registering securities. *Id.* § 23-2-1-4 sets forth the procedures for registration by coordination when a registration statement has been filed with the Securities and Exchange Commission in connection with the same offering under the Federal Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1970). The more complex registration by qualification procedures, which apply when no registration statement will be filed with the SEC, are set forth in IND. CODE § 23-2-1-5 (Burns 1972). For a brief, but comprehensive, comparison of the treatment of nonissuer transactions under the Securities Act of 1933 and the state securities acts, commonly known as "Blue Sky Laws," see Note, *Regulation of Nonissuer Transactions Under Federal and State Securities Registration Laws*, 78 HARV. L. REV. 1635 (1965). For a general discussion of Blue Sky Laws, see 14 W. FLETCHER, PRIVATE CORPORATIONS §§ 6738-44 (perm. repl. ed. 1965) [hereinafter cited as FLETCHER]; H. HENN, LAW OF CORPORATIONS §§ 306-08 (1970) [hereinafter cited as HENN]; N. LATTIN, CORPORATIONS § 44 (2d ed. 1971) [hereinafter cited as LATTIN]. State securities legislation is extensively and critically treated in L. LOSS & E. COWETT, BLUE SKY LAWS (1958). For a general discussion of registration requirements under the Indiana statute, see Note, *Securities Registration Requirements in Indiana*, 3 IND. LEGAL F. 270 (1969).

[26] IND. CODE § 23-2-1-19(e) (Burns 1972).

[27] *Id.* § 23-2-1-12 provides:

> It is unlawful for any person in connection with the offer, sale or purchase of any security, either directly or indirectly, (1) to employ any device, scheme or artifice to defraud, or (2) to make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of circumstances under which they are made, not misleading, or (3) to

and (2) the sale violated the registration requirements of the Securities Law and thus was voidable under the civil penalty section.[28]

After a two day trial, the court found that Hippensteel had failed to prove his statutory and common law fraud allegations and that the sale was exempt from the registration requirements of the statute. Only the exemption issue was before the appellate court since the negative judgment on the fraud question presented no issue for review.[29] On the exemption issue, the court of appeals held that the trial court erred in concluding that Karol had successfully met his burden of establishing that the transaction was exempt.[30] Karol claimed the transaction was exempt on two statutory grounds. The first one discussed was Indiana Code section 23-2-1-2(b)(10), which exempts the offer or sale of unregistered securities if, during a period of twelve consecutive months, the offeror has not directed offers to sell securities of the same class to more than twenty persons.[31]

Karol unquestionably had offered the securities to less than twenty persons, but he ran afoul of the additional requirement that either each buyer must represent in writing to the seller that the securities are purchased for investment purposes or the seller must obtain a ruling of the Securities Commissioner waiving the conditions.[32] The purchasers no doubt bought the securities for invest-

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> engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

This provision closely parallels rule 10b-5, 17 C.F.R. 240.10b-5 (1973), promulgated by the SEC under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970). Like the Indiana Securities Law in effect in 1959 which was involved in Soft Water Utilities, Inc. v. LeFevre, 308 N.E.2d 395 (Ind. Ct. App. 1974), discussed at text accompanying notes 2-22 *supra*, the rights and remedies available under the current act are not exclusive. IND. CODE § 23-2-1-19(h) (Burns 1972).

[28]IND. CODE § 23-2-1-19 (Burns 1972). This section provides that one who offers or sells a security by means of misrepresentations, either active or passive, is liable to the purchaser for the amount paid or for damages in the event the purchaser no longer owns the security. The civil penalty is in addition to the criminal penalties authorized by *id.* § 23-2-1-18.

[29]*See* Schuh v. State, 251 Ind. 403, 406, 241 N.E.2d 362, 364 (1968); Engelbrecht v. Property Developers, Inc., 296 N.E.2d 798, 801 (Ind. Ct. App. 1973).

[30]IND. CODE § 23-2-1-16(j) (Burns 1972) provides that the burden of proof of an exemption or a classification from the application of the act "shall be upon the party claiming the benefits of such exemption or classification." For a general discussion of exemptions under the Indiana act, see Note, *Securities Registration Requirements in Indiana*, 3 IND. LEGAL F. 270, 285-94 (1969).

[31]IND. CODE § 23-2-1-2(b)(10) (Burns 1972). Excluded from this calculation are persons receiving offers which would otherwise be exempt.

[32]*Id.* This provision is based on UNIFORM SECURITIES ACT § 402(b)(9).

ment, albeit speculative investment. However, Karol could produce neither the so-called investment letters[33] nor a ruling of the Commissioner. Thus the appellate court was constrained to hold that he had failed to carry his burden establishing the exemption. While Karol no doubt argued that section 23-2-1-2(b)(10) laid a statutory trap for the non-professional seller of unregistered securities, the court had no choice except to follow the explicit language of the statute and deny the exemption on this ground.[34]

The second possible exemption[35] discussed by the court was provided by Indiana Code section 23-2-1-2(b)(1), which exempts "any isolated nonissuer transaction, whether effected through a broker-dealer or not."[36] Thus the court was required to decide whether the sale of the eighteen units for $108,000 during early 1967 and the somewhat later sale to Hippensteel of five units for $30,000 could be considered "isolated transactions." The court said no. In so holding, it was the first Indiana court to construe the meaning of the word "isolated." This was a difficult task since "definitional indefiniteness is . . . traditionally and probably inevitable"[37] in this area of the law and is only eased somewhat by the fact that the language was taken verbatim from the Uniform Securities Act.[38]

The appellate court noted that although isolated transaction exemptions are nearly universal, the form varies and the authorities on point are limited. In fact, only three of the twenty-seven jurisdictions that have adopted the Uniform Securities Act have

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[33]Investment letters are, or perhaps more accurately were, quite significant in the "private placement exemption" under section 4(1) of the Securities Act of 1933, 15 U.S.C. § 77d(1) (1970). The past tense reference is prompted by rule 144, 17 C.F.R. § 230.144 (1973), recently promulgated by the SEC, which rule substantially tightens the requirements for disposing of unregistered securities. *See generally* Miller & Seltzer, *The S.E.C.'s New Rule 144*, 27 BUS. LAW. 1047 (1972); Wheat, Phillips, Wander & Garrett, *Developments in Private Placements, Distribution of Restricted Securities; Rule 144*, 28 BUS. LAW. 483 (1973).

[34]304 N.E.2d at 802. *See generally* Note, *Securities Registration Requirements in Indiana*, 3 IND. LEGAL F. 270, 291-92 (1969).

[35]The court recognized that the decision had to be affirmed if there were an alternative basis supporting the trial court's conclusions. *See* Indiana & Mich. Elec. Co. v. Schnuck, 298 N.E.2d 436, 438 (Ind. 1973); 3 F. WILTROUT, INDIANA PRACTICE § 2790(1) (1967).

[36]IND. CODE § 23-2-1-2(b)(1) (Burns 1972).

[37]304 N.E.2d at 800. The court cited L. LOSS & E. COWETT, BLUE SKY LAWS 317-19 (1958), and the Official Comments to sections 305(i) and (j) of UNIFORM SECURITIES ACT § 305, although the latter reference is somewhat obscure.

[38]UNIFORM SECURITIES ACT § 402(b)(1) (as amended August, 1958). *See generally* Note, *Securities Registration Requirements in Indiana*, 3 IND. LEGAL F. 270, 286-87 (1969).

case law interpreting the exemption.[39] The court relied primarily on *Nelson v. State*,[40] in which the Oklahoma Court of Criminal Appeals affirmed the conviction of Nelson for selling unregistered stock. In so doing, the court defined the term "isolated sale" to mean "one standing alone, disconnected from any other . . . [and] of a nonrecurring nature engaged in by persons not engaged in the securities business. . . ."[41] A similar approach was adopted by the Kentucky Court of Appeals in *Commonwealth v. Allen*,[42] in which case the defendant had contacted thirty persons but had sold unregistered securities to only ten. The *Allen* court held that evidence of all the sales or offers determines whether the sale in question was an isolated transaction. The *Hippensteel* court likewise examined all of Karol's transactions in rejecting his exemption argument.

The appellate court also cited *Allen v. Schauf*,[43] in which the Kansas Supreme Court held that a challenged transaction was exempt. The *Schauf* case is instructive because the result turned not on an analysis of the particular transaction but on the application of an administrative regulation defining isolated transactions as those in which the number of persons solicited during any twelve month period is less than four.[44] The Indiana court showed a clear preference for this "definitive regulations" approach. The court not only expressed regret that it had no choice but to adopt the approach of the Oklahoma court in *Nelson*,[45] but also very pointedly noted that two states, Mississippi and Tennessee, had promulgated administrative regulations defining the limits of their statutes' exemptions.[46]

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[39]Allen v. Schauf, 202 Kan. 348, 449 P.2d 1010 (1969); Commonwealth v. Allen, 441 S.W.2d 424 (Ky. Ct. App. 1969); Sisson v. State, 404 P.2d 55, (Okla. Crim. App. 1964); Nelson v. State, 355 P.2d 413 (Okla. Crim. App. 1960). *See* 69 AM. JUR. 2d *Securities Regulation—State* § 79, at 1113 (1973).

[40]355 P.2d 413 (Okla. Crim. App. 1960). The *Nelson* case was followed in Sisson v. State, 404 P.2d 55 (Okla. Crim. App. 1964), in which the court held that the sale of securities of an insurance company to more than ten persons did not qualify under the exemption.

[41]355 P.2d at 420. Further, the court stated that the word isolated is not a word of art, but "is a term the application of which must depend on the facts of each case." *Id.*

[42]441 S.W.2d 424 (Ky. Ct. App. 1969).

[43]202 Kan. 348, 449 P.2d 1010 (1969).

[44]2 KAN. AD. RULES & REG. § 81-1-1.

[45]304 N.E.2d at 801.

[46]*Id.* at 801 n.3. Section 75-71-53.3 of the Mississippi Blue Sky Law, MISS. CODE ANN. §§ 75-71-1 to -57 (1972), exempts isolated transactions, which are defined by Mississippi Regulation § 138(c) as not more than two transactions of similar character within any consecutive six month period. The Tennessee statute, TENN. CODE ANN. § 48-1632(D) (1964), also exempts

The court seemed to favor the isolated transaction approach taken by non-uniform act jurisdictions which do not have administrative regulations.[47] It is doubtful that the court would have ruled for Karol even if it had been free to rely on the interpretations given to other statutes. Perhaps it simply felt that the rule of cases such as *Kneeland v. Emerton*[48] was clearer and easier to apply. In *Kneeland,* the Massachusetts Supreme Court dealt at length with the isolated transaction problem and opined that an exempt sale was "[a]ny isolated sale of any security by the owner thereof . . . such sale not being made in the course of repeated or successive transactions of a like character . . . ."[49] In rejecting defendant's challenge to the constitutionality of the provision, the *Kneeland* court pointed out that the reference to "repeated and successive transactions of a like character" was intended to contrast with the term "isolated sales" and stated that, in fact, as few as two successive sales of securities can remove the second sale from the exempt category if it is determined that the seller intended to make repeated and successive sales of the unregistered security.[50] This poses an intriguing possibility in the context of *Hippensteel.* Could the *first* sale be considered as part of a "repeated and successive" transaction and, if so, could the first purchaser rescind his purchase if not barred by the statute of limitations?

To make clear its point on the regulatory approach to the isolated sales exemption, the *Hippensteel* court opined that, "without an administrative regulation, only strict compliance with the statutory requirements will effect an exemption."[51] Since the last of nine separate sales within a six month period of twenty-three units of securities for $138,000 could be deemed an "isolated transaction" only by a quantum stretch of the imagination, Karol failed to establish an exemption under section 23-2-1-2(b)(1). Thus Hippensteel was clearly entitled to rescind the transaction under the Securities Law. The result in *Hippensteel* is not shocking but its stringent application in other situations might give a sharp investor a perfect speculative investment, that is, one with high potential gain and no

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such transactions. This exemption has been limited by the Tennessee Division of Securities to no more than ten repeated and successive transactions. *See generally* Miller, *Procedures Under the Tennessee Securities Law,* 28 TENN. L. REV. 303, 308 (1961).

[47]304 N.E.2d at 801 n.4.

[48]280 Mass. 371, 183 N.E. 155 (1932).

[49]*Id.* at 381, 183 N.E. at 160. Since the sale was by a registered broker, the court simply ruled that he could not benefit from an exemption designed for the owners of unregistered securities.

[50]*Id.* at 388-89, 183 N.E. at 163.

[51]304 N.E.2d at 802.

downside risk so long as suit is filed before the statute of limitations runs.

C. *Fiduciary Obligations and Dividend Policies*

The obligations of a majority shareholder of a closely held corporation and the situation in which a court of equity will order the payment of a corporate dividend were the issues resolved by the Third District Court of Appeals in *Cole Real Estate Corp. v. Peoples Bank & Trust Co.*[52] Plaintiff bank, as trustee, owned 86 of the 4,120 common shares of Cole Real Estate Corporation and brought this suit against the corporation and Helen F. Cole, who was the owner of the balance of the stock and the corporation's president, treasurer and sole employee. The trustee sought an accounting for and recovery of corporate assets and an order declaring a dividend. The trial court held that Cole had converted corporate assets to her own use and benefit and that the corporation had sufficient assets to permit a dividend of $1 per share for each of the years from 1964 to 1970. The sole issue on appeal was the sufficiency of the evidence supporting the findings of the trial court. The appellate court concluded that the evidence was sufficient and affirmed the judgment after modifying it by reducing the amount of the award.[53]

Although the corporation was formed in 1935, there was little evidence that a corporate identity had been maintained. Cole had not filed annual reports for several years and the most recent board of directors meeting was held in 1954 when the corporation was reorganized. Cole testified that she could not recall when the present board took office. She knew the General Corporation Act required annual meetings of shareholders,[54] but none had been held because of a lack of interest. Cole had the use of two company-owned cars and lived rent free in a home owned by the corporation which served as the corporate office from which she managed the business. She further testified that she had set her own salary from 1964 to 1970, ranging from $4,593.16 in 1964 to a high of $10,998.20 in 1967, without consulting the board of directors.

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[52]310 N.E.2d 275 (Ind. Ct. App. 1974) (Staton, J.).

[53]*Id.* at 282. The trial court awarded attorneys' fees to the Peoples Bank. The amount of these fees was also reduced on appeal. The court noted that the defendants had made only a weak attack on this award and concluded that the award was justified in an equitable proceeding by a minority shareholder to compel those in control to restore money wrongfully converted. *Id.* at 280 n.3. *See* Princeton Coal & Mining Co. v. Gilchrist, 51 Ind. App. 216, 224, 99 N.E. 426, 428-29 (1912); Atwater v. Elkhorn Valley Coal Land Co., 184 App. Div. 253, 171 N.Y.S. 552, *aff'd*, 227 N.Y. 611, 125 N.E. 912 (1918).

[54]Ind. Code § 23-1-2-9(b) (Burns 1972).

Defendants first attacked the judgment on the "assumption," in the words of the court, that the minority shareholder could not maintain the derivative action because of failure to exhaust intracorporate remedies before filing suit.[55] Although this is a well settled principle of corporate law,[56] it is equally well settled that a demand for corporate action is unnecessary prior to filing suit on behalf of a corporation when the directors have acted in their own interests or the majority shareholder has acted illegally or oppressively in the corporate name.[57] The court cited *First Merchants National Bank & Trust Co. v. Murdock Realty Co.*[58] as authority. *Murdock* involved corporate officers who had mortgaged company-

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[55]310 N.E.2d at 278. Perhaps "assumption" was the right word since the actual theory of the case is not absolutely clear. Although a shareholder derivative action, rather than a direct action, is the normal method of recovering corporate assets from insiders who have abused their trust, the court here refers to the suit as an individual action. The rationale in support of derivative actions is clear. The corporation itself, rather than the individual shareholder, has been injured by the acts of the defendants and the cause of action normally lies with the corporation. Thus, any right of action by a shareholder is "derived" from the action accruing to the corporation. *See* Gordon v. Elliman, 306 N.Y. 456, 119 N.E.2d 331 (1954). This is true even in those derivative actions in which recovery goes to the shareholders rather than to the corporation. *See, e.g.*, Perlman v. Feldmann, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955). For a general discussion comparing derivative actions with direct actions, see 5 FLETCHER § 2171; HENN §§ 358, 360; LATTIN § 102.

[56]Tevis v. Hammersmith, 31 Ind. App. 281, 66 N.E. 79 (1903). Derivative actions are controlled by the provisions of the Indiana Rules of Trial Procedure which provide, in pertinent part, that the shareholder must "allege with particularity the efforts, if any, made by the plaintiff, to obtain the action he desires from the directors or comparable authority and the reasons for his failure to obtain the action or for not making the effort. . . ." IND. R. TR. P. 23.1. The requirement that a plaintiff shareholder exhaust intracorporate remedies before suit is designed to afford the corporation an opportunity to conduct its own litigation since it is the principal party in interest. *See, e.g.*, Kowalski v. Nebraska-Iowa Packing Co., 160 Neb. 609, 71 N.W.2d 147 (1955). *See generally* 3 FLETCHER § 1284; 13 *id.* §§ 5963, 6008; 2 W. HARVEY, INDIANA PRACTICE 365-75 (1970); HENN §§ 364-67; LATTIN § 105.

[57]*See* First Merchants Nat'l Bank & Trust Co. v. Murdock Realty Co., 111 Ind. App. 226, 39 N.E.2d 507 (1942). *See also* Somberg v. Bluemschine, 8 F.R.D. 198 (S.D.N.Y. 1948); Campbell v. Loew's, Inc., 36 Del. Ch. 563, 134 A.2d 852 (1957); Reed v. Norman, 48 Cal. 2d 338, 309 P.2d 809 (1957). If the board of directors declines to enforce the corporation's right in the exercise of sound business judgment, unaffected by personal interest, the shareholder will be barred from bringing the action. *See, e.g.*, Swanson v. Traer, 249 F.2d 854, 858-59 (7th Cir. 1957). *See generally* 2 FLETCHER § 535; 3 *id.* § 1283; 2 W. HARVEY, INDIANA PRACTICE 365 (1970); HENN § 365; LATTIN § 105.

[58]111 Ind. App. 226, 39 N.E.2d 507 (1942).

owned property to secure individual debts. When suit was brought to foreclose the mortgage, a minority shareholder was permitted to intervene on behalf of the corporation. The court reasoned that corporate officers, whose conduct was being questioned, could not be expected to adequately defend an action involving dissipation of corporate assets. Since it would have been "an idle gesture"[59] for the shareholder to demand that the corporate officials defend the action, the court placed the suit among those actions in which shareholders can act directly.[60] While the theory of the *Cole* case might be obscure, there can be little doubt that it would have been futile to require the bank to demand that Cole sue herself.

Defendant Cole then contended, or "assumed," that there was insufficient proof that the compensation she had personally set for herself was so unreasonable as to amount to a conversion of corporate assets. The court recognized that setting the compensation of corporate personnel is primarily the province of the board of directors and that courts should interfere only in exceptional circumstances. It stated that "to be successful, an attack on the amount of compensation paid to a corporate officer-employee must support a finding that the salary in question is unreasonable or unfair."[61] The court cited *Green v. Felton*,[62] in which minority shareholders alleged that the directors and majority shareholders of a company had fraudulently elected themselves directors and had fixed their salaries at excessive levels. In ruling for the defendants, the *Green* court observed:

> But to give the court authority to set aside the action of majority stockholders or board of directors, legally acting under the rules of the company, legally adopted, there must appear injustice or oppression, or circumstances amounting to fraud.[63]

Finding little comfort in the rule of the *Green* case, the appellate court neatly sidestepped the problem by concluding that Cole was

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[59]*Id.* at 237, 39 N.E.2d at 512.

[60]The court relied on Marcovich v. O'Brien, 63 Ind. App. 101, 114 N.E. 100 (1916), which delineated those instances when the law recognizes the right of shareholders to institute or defend actions directly, including "where a majority of the stockholders are illegally or oppressively pursuing a course in the name of the corporation, which is in violation of the right of the other stockholders and can only be restrained by a court of equity." *Id.* at 111, 114 N.E. at 103.

[61]310 N.E.2d at 279. For a general discussion of corporate compensation, see 3 FLETCHER § 1110; 5 *id.* §§ 2109 *et seq.;* HENN §§ 243-45, 255; LATTIN § 77; 2 H. O'NEAL, CLOSE CORPORATIONS §§ 8.10, 8.12 (1971).

[62]42 Ind. App. 675, 84 N.E. 166 (1908).

[63]*Id.* at 685-86, 84 N.E. at 170.

outside the ambit of the *Green* rule, since she ran the corporation "unbridled by even a modicum of corporate formality."[64]

The *Cole* court recognized that, in certain respects, closed corporations may be distinguished from their publicly owned counterparts on matters of corporate formality and internal operation. However, this concession does not countenance the use of corporate assets by insiders for their personal gain.[65] The court then posited that equity will provide a remedy when a majority shareholder appropriates the corporate earnings for salaries.[66] But equivocating once again, and not wishing to "act as the regulator of a private corporation . . . in determining what is a fair and reasonable compensation,"[67] the court put the burden of establishing the unreasonableness of the compensation on the minority shareholder bringing the action. The real problem with the opinion is that the court did not make clear whether this rule applies only when formal corporate action has occurred or when, as in *Cole*, the challenged officer has not followed what can be called the corporate "rules."

In resolving the burden issue, the court relied on two non-Indiana decisions: *Coleman v. Plantation Golf Club, Inc.*[68] and *Seitz v. Union Brass & Metal Manufacturing Co.*[69] The *Coleman* case clearly supports the proposition advanced by the *Cole* court. The *Coleman* court held that the minority shareholder bringing the derivative action was required to prove that the salaries were not reasonable or, stated conversely, that they were clearly excessive and wasteful. The *Seitz* case was an action to compel a corporation to declare a dividend and to compel certain officers to repay excessive salaries. The Minnesota court ordered the dividend but refused to compel the officers to repay their salaries because the dissenting shareholder had not proved the requisite wrongdoing or

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[64]310 N.E.2d at 279.

[65]Madding v. Indiana Dep't of State Revenue, 270 N.E.2d 771 (Ind. Ct. App. 1971); Tower Recreation, Inc. v. Beard, 141 Ind. App. 649, 231 N.E.2d 154 (1967); First Nat'l Bank & Trust Co. v. Murdock Realty Co., 111 Ind. App. 226, 39 N.E.2d 507 (1942).

[66]The court cited Wayne Pike Co. v. Hammons, 129 Ind. 368, 27 N.E. 487 (1891), in which the supreme court affirmed a judgment for a minority shareholder who charged that corporate officers and majority shareholders were paying themselves exorbitant salaries and using corporate funds to purchase equipment for personal business.

[67]310 N.E.2d at 279. *See generally* 5 FLETCHER § 2122; LATTIN § 77, at 266. Many authorities clearly put the burden on the recipient to prove that the compensation is fair and reasonable when his participation was necessary to approve the compensation or salary. *See* Church v. Harnit, 35 F.2d 499 (6th Cir. 1929), *cert. denied,* 281 U.S. 732 (1930). *Cf.* Globe Woolen Co. v. Utica Gas & Elec. Co., 224 N.Y. 483, 121 N.E. 378 (1918).

[68]212 So. 2d 806 (Fla. App. 1968).

[69]152 Minn. 460, 189 N.W. 586 (1922). *See* Annot., 27 A.L.R. 300 (1923).

oppression.[70] The *Seitz* court emphasized that the salaries had been fixed on a regular basis by the board of directors, which was not true in *Cole.*

After ostensibly putting the burden on the plaintiff, the appellate court undercut its position by concluding that the burden "was met by showing an unauthorized appropriation of corporate assets to Helen Cole's own use in the absence of reasonable justification."[71] The court did not discuss the reasonable value of the use of the home and the automobiles. More importantly, there was no inquiry into the compensation received by officers of similarly situated corporations. Such an inquiry would seem essential, even when a court is reluctant to overturn the findings of the lower court. Rather, the court seemed to take the position that, since Cole had not observed the corporate formalities, *any* compensation she received from her unilateral acts would be unreasonable and excessive. This probably is a correct and desirable result that will force corporate personnel to comply with the less than burdensome corporate formalities required by both the common law and the General Corporation Act. However, the result could have been reached without this judicial "tour de force" if the court had simply stated that a dominant owner of a corporation who ignores such formalities has the burden of justifying his salary or compensation.[72]

The second issue in *Cole* was whether the trial court erred in ordering a dividend. The appellate court held that the judgment was supported by sufficient evidence. The court recognized that the decision to declare a dividend is within the discretion of the board of directors, subject to certain statutory requirements.[73] A court will compel a dividend in appropriate cases but, as the court noted, the burden of proof on a shareholder seeking such relief is necessarily stringent and "only a clear abuse of discretion, established by proof

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[70]152 Minn. at 464-65, 189 N.W. at 588.

[71]310 N.E.2d at 280.

[72]*See* authorities cited note 67 *supra*. *See also* HENN § 255. After concluding that the trial court was correct on the liability issue, the appellate court found that the trial court erred in computing the judgment based on an assessed conversion of $75 per month over the seven year period. Thus, it reduced the judgment from $7,000 to $6,300 pursuant to IND. R. APP. P. 15(M).

[73]IND. CODE § 23-1-2-15 (Burns 1972) sets forth the statutory requirements for dividends. The provision gives corporate directors the power, subject to any restrictions contained in the articles of incorporation, to declare and pay dividends on outstanding shares. The section requires that the dividends be paid only out of unreserved and unrestricted earned surplus and precludes the payment of dividends if the corporation is, or thereby becomes, insolvent or if the stated capital of the corporation is, or thereby becomes, impaired. Partial liquidating dividends paid out of capital surplus are permitted by *id.* § 23-1-2-15(f).

of bad faith, oppressive or illegal action, will justify the intervention of a court of equity."[74]

The court cited three Indiana cases to support the general proposition that a court can order dividends: *Star Publishing v. Ball,*[75] *W.Q. O'Neall Co. v. O'Neall,*[76] and *Rubens v. Marion-Washington Realty Corp.*[77] While these cases were initiated by preferred shareholders, the *Cole* court held that such relief was not limited to that class of shareholders. In general, directors may exercise discretion in deciding to pass dividends, even on cumulative preferred stock.[78] As the *Cole* court rightly observed, the key element in an action to order payment is a showing of an abuse of discretion in passing a dividend. Thus, there is no logical reason why the remedy would be foreclosed to common shareholders. The court cited two New York cases in support of this proposition: *City Bank Farmers Trust Co. v. Hewitt Realty Co.*[79] and *Gordon v. Elliman.*[80]

In *City Bank,* the court recognized that a petition to compel dividends on common stock could be granted under appropriate circumstances. However, the court refused to compel payment because minority shareholders are barred from interfering with the management of the corporation so long as the directors are acting hon-

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[74]310 N.E.2d at 280. For a general discussion of actions to compel the payment of dividends, see 11 FLETCHER § 5325; HENN §§ 328 & 360, at 759-60; LATTIN §§ 144-45; 2 H. O'NEAL, *supra* note 61, § 8.08; Comment, *Proposals to Help the Minority Shareholder Receive Fairer Dividend Treatment from the Closely Held Corporation,* 56 NW. U.L. REV. 503 (1961); Note, *Minority Shareholders' Power to Compel Declaration of Dividends in Close Corporations—A New Approach,* 10 RUTGERS L. REV. 723 (1956).

[75]192 Ind. 158, 134 N.E. 285 (1922). The court ordered dividends on preferred shares since the owner of all the common stock had paid himself five percent common stock dividends while passing the preferred dividends.

[76]108 Ind. App. 116, 25 N.E.2d 656 (1940). The court ordered payment of dividends when the majority shareholder in bad faith refused to declare them. The court, however, refused to affirm that portion of the trial court's ruling mandating the corporation to pay future dividends, stating that the duty to declare dividends "rests in the sound discretion of the directors." *Id.* at 130, 25 N.E.2d at 662. A court may interfere only on a showing of abuse of that discretion. *Id.*

[77]116 Ind. App. 55, 59 N.E.2d 907 (1945), *noted in* 44 MICH. L. REV. 318 (1945). The court held that, when mandatory dividends were subject to certain conditions, the shareholders' remedy was in equity until the dividend was declared.

[78]Guttmann v. Illinois Central R.R., 189 F.2d 927 (2d Cir.), *cert. denied,* 342 U.S. 867 (1951); Matter of Carlisle, 53 Misc. 2d 546, 278 N.Y.S.2d 1011 (Sur. Ct. 1967). *See generally* H. BALLENTINE, BALLENTINE ON CORPORATIONS § 231 (rev. ed. 1946); 11 FLETCHER § 5325; HENN §§ 325, 327; LATTIN § 144.

[79]257 N.Y. 62, 177 N.E. 309 (1931).

[80]306 N.Y. 456, 119 N.E.2d 331 (1954).

estly and within their discretionary powers. In other words, the plaintiffs had failed to meet their burden of proving abuse of discretion. The court, in *Gordon,* also concluded that common shareholders can sue to compel dividends on a corporation's common stock.[81] The main holding of *Gordon,* however, was that such equitable actions are derivative rather than direct in nature.[82]

In disposing of the argument that payment of the dividend would require an invasion of capital, the *Cole* court pointed out that dividends are not necessarily paid out of current taxable income but rather are paid out of the corporation's earned surplus which has built up over the years.[83] In the court's opinion, the record showed that Cole Real Estate Corporation had sufficient earned surplus to pay the dividends for each of the years without invading capital. Moreover, even after the payment of the dividends, the company would still maintain a sizeable earned surplus.

Of course, the mere financial ability to pay a dividend will not justify a court's interference since a corporation has the right to retain earned surplus to insure financial stability and to effect internal policies and programs.[84] The key question is whether the decision not to declare a dividend clearly demonstrates oppressive

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[81]It is interesting to note that the *Cole* court did not cite or rely upon the classic case of Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919). The Dodge brothers, who ultimately formed their own automobile company, were minority shareholders of the Ford Motor Company. They sued to compel a dividend out of the corporation's substantial accumulated cash and surplus after Henry Ford, the majority shareholder, had declined to declare dividends. Ford preferred to share corporate gains with the public by reducing the price of Ford cars. In effect, Ford made the company less profitable. After recognizing that corporate managers have a great deal of discretion in determining the use of corporate funds, the Michigan Supreme Court concluded that the company was not a "semi-eleemosynary institution" and affirmed the lower court's decree that a dividend of $19,275,000 be paid. The *Dodge* case is noted in 20 COLUM. L. REV. 93 (1920); 17 MICH. L. REV. 502 (1919); 28 YALE L.J. 710 (1919).

[82]Not all authorities agree on this point. *See, e.g.,* Knapp v. Bankers Sec. Corp., 230 F.2d 717 (3d Cir. 1956). *See generally* 11 FLETCHER § 5326.1; HENN § 360, at 759-60; LATTIN § 145. In effect, *Gordon* has been overruled by statute. N.Y. BUS. CORP. LAW § 627 (McKinney 1954). The *Cole* court stated it was unnecessary to decide the status of the action. 310 N.E.2d at 281 n.5.

[83]The court again rejected the argument that the plaintiff had failed to exhaust intracorporate remedies. The court noted that a similar contention was raised and rejected in W.Q. O'Neall Corp. v. O'Neall, 108 Ind. App. 116, 25 N.E.2d 656 (1940).

[84]*See, e.g.,* City Bank Farmers Trust Co. v. Hewitt Realty Co., 257 N.Y. 62, 177 N.E. 309 (1931); Jones v. Costlow, 349 Pa. 136, 36 A.2d 460 (1944). *See generally* 11 FLETCHER § 5325; HENN § 320; 2 H. O'NEAL, *supra* note 61, § 8.08, at 59-60. For a basic discussion of the accounting principles relevant to dividends, see HENN § 319 and authorities cited *id.* at 633 n.1.

action by the controlling shareholder. In *Cole,* the court concluded that this requirement was satisfied by the showing that Cole had withdrawn all of the earnings of the corporation in salary and compensation in lieu of declaring dividends which, albeit to only a small degree, would be shared by the beneficiaries of the trust represented by the plaintiff bank.[85] Finally, the court upheld the order against Cole which set off the amount of the judgment against the amount of dividends accruing on her shares. The court followed the rule that a debt of a shareholder owed to a corporation may be set off against a declared dividend, which is, in fact, a debt owed to the shareholders.[86]

D. *Fiduciary Obligations of Corporate Management*

The fiduciary duty of a shareholder of a closely held corporation was a major issue in *Hartung v. Architects Hartung/Odle/Burke, Inc.,*[87] in which the First District Court of Appeals affirmed a $17,500 damage judgment against Hartung entered by the Greene County Circuit Court.[88] The litigation arose out of the short-lived corporate successor to a sole proprietorship headed by Hartung. Odle and Burke, architect employees of Hartung, joined with him as incorporators of the new venture. Each owned equal shares of the corporation and were directors. Hartung was the president of the corporation and Odle and Burke were unspecified officers. The firm's offices and its clients were assigned to the corporation when it was formed. The corporate venture was ill-advised and defendant Hartung resigned approximately four months after the corporation was formed. Odle and Burke individually and as corporate officers then sued for damages caused by a breach of Hartung's fiduciary obligations to the corporation. More particularly, Hartung was charged with usurping corporate opportunities and corporate assets.

Hartung made a three pronged attack on the judgment against him. He claimed that (1) the evidence was insufficient to establish a fiduciary duty, (2) assuming a fiduciary duty existed, the evi-

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[85]The plaintiff bank owned only 86 shares and the total amount it would receive as dividends for the seven year period was $602. It is possible to wonder why the case was not settled long before it got to the appellate level.

[86]*See* Fricke v. Angemeier, 53 Ind. App. 140, 101 N.E. 329 (1913). *See also* Harr v. Bankers Sec. Corp., 129 Pa. Super. 547, 196 A. 522 (1938); 11 FLETCHER § 5374.

[87]301 N.E.2d 240 (Ind. Ct. App. 1973) (Robertson, J.).

[88]Hartung was also ordered to contribute $1,362.32 as his co-guarantor's share of a corporate note that had been satisfied by plaintiffs Odle and Burke. Hartung contended that a co-guarantor of a note could not be forced to contribute when the principal obligor had sufficient funds. The court rejected this contention under both the UNIFORM COMMERCIAL CODE § 3-416(1), and the common law. Hamilton v. Meiks, 210 Ind. 610, 4 N.E.2d 536 (1936).

dence did not show it had been breached, and (3) even if the duty had been breached, plaintiffs had failed to show specific and non-speculative damages.[89] On the first issue, the court concluded that Hartung was under a fiduciary duty to act fairly, honestly, and openly with the corporation and his associates in all three of his capacities—as director, officer, and shareholder.

Although directors and officers have long been treated as fiduciaries under Indiana law,[90] the court relied on two non-Indiana cases to establish Hartung's fiduciary obligation as a shareholder: *Helms v. Duckworth*[91] and *Manis v. Miller*.[92] *Helms* was an action to cancel a stock purchase agreement which provided that, upon the death of either of the two owners of a corporation, the survivor was entitled to buy the deceased's shares at a price of $10 or as renegotiated annually by mutual agreement. The price was never changed. The District of Columbia Court of Appeals concluded that, since the defendant, who was the minority shareholder, might never have intended to renegotiate the stock price in line with his agreement, he had breached the duty owed his fellow shareholder. The court enunciated the belief that "the holders of closely-held stock . . . bear a fiduciary duty to deal fairly, honestly, and openly with their fellow stockholders and to make disclosures of all essential information."[93]

Manis was a contest between the estates of the owners of a corporation who had agreed that neither would sell his stock without first offering it to the other. The agreement further provided that, if the offer were declined, the corporation would be deemed dissolved and either owner could solicit the business of any of its customers. One of the shareholders offered to sell his shares. When the offer was declined, he organized a new corporation and took over the facilities and equipment of the allegedly dissolved corporation. The New York court, in the derivative action, ruled that the takeover was a breach of the shareholder's duty to the corporation,

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[89]301 N.E.2d at 242-43.

[90]The court cited Central Ry. Signal Co. v. Longden, 194 F.2d 310 (7th Cir. 1952) (officer); Leader Publishing Co. v. Grant Trust & Savings Co., 182 Ind. 651, 108 N.E. 121 (1915) (officer); Hill v. Nisbet, 100 Ind. 341 (1885) (director); Tower Recreation, Inc. v. Beard, 141 Ind. App. 649, 231 N.E.2d 154 (1967) (director). The *Leader* case is discussed at text accompanying notes 97-99 *infra.* For a general discussion of the fiduciary obligations of corporate personnel, see 3 FLETCHER § 838; HENN §§ 235-42, 268, and authorities cited *id.* at 458 n.3; LATTIN §§ 79-80.

[91]249 F.2d 482 (D.C. Cir. 1957).

[92]19 N.Y.2d 875, 227 N.E.2d 596, 280 N.Y.S.2d 675 (1967). *See generally* 13 FLETCHER § 5811; HENN § 268; Conway, *The New York Fiduciary Concept in Incorporated Partnerships and Joint Ventures*, 30 FORDHAM L. REV. 297 (1961).

[93]249 F.2d at 487.

notwithstanding the fact that it was ostensibly permitted by the agreement. The purported dissolution was a nullity, and the duty continued in the absence of the legal dissolution of the corporation.[94]

Hartung made the intriguing argument that, since the "incorporated partnership" consisted of professionals, a fiduciary duty could not arise. His contention, which the court noted was not supported by authority, was that professionals serving clients must have more "leeway" in their relationships with corporate associates. He argued that a stringent fiduciary duty would unduly restrict the freedom needed to maintain his professional status. In rejecting this contention, the court posited that the critical factor giving rise to the duty was not the work product of the corporation but rather was the relationship expected by the principals among themselves and with the corporation. Although it is conceivable that the duty owed corporate associates might be accommodated under some circumstances to the duty owed professional clients, the court was correct in refusing to accept the broad exemption claimed by Hartung.[95] The court of appeals also rejected Hartung's contention that no duty existed at the time of the alleged breach because he had severed his relationship with the corporation on June 15, 1971. The court concluded that the evidence did not sustain the claim of severance of the relationship, since it appeared that Hartung had maintained sufficient contact until mid-July to maintain, as well, his fiduciary duty.[96]

With respect to Hartung's second argument, the court found that the evidence presented at trial supported the finding that Hartung had breached his duty. His first offense was in taking over the firm's office for his own use while still with the company. Although the lease was on a month-to-month basis, the court concluded the corporation had a sufficient expectancy of renewal to make the

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[94]Professor Henn cites both *Manis* and *Helms* for the proposition that, "in the close corporation, not only do the normal fiduciary duties of controlling shareholders apply, but in addition the courts are prone to require a higher standard of fiduciary responsibility." HENN § 268.

[95]Perhaps Hartung's argument would be more persuasive if the corporation involved had been formed under one of Indiana's professional corporation acts. IND. CODE §§ 23-1-13-1 to -11 (Burns 1972) (general); *id.* §§ 23-1-13.5-1 to -6 (Burns Supp. 1974) (accounting); *id.* §§ 23-1-14-1 to -21 (Burns 1972) (medical); *id.* §§ 23-1-15-1 to -21 (dental).

[96]Generally, the fiduciary obligation terminates with the relationship, 19 AM. JUR. 2d *Corporations* §§ 1273, 1282 (1965), but liability will attach for acts commenced during the period of the relationship but completed later. The duty also precludes the use of confidential information obtained before the termination of the relationship. *See, e.g.,* California Intelligence Bureau v. Cunningham, 83 Cal. App. 2d 197, 188 P.2d 303 (1948). *See generally* Comment, *The Obligation of a High-Level Employee to His Former Employer: The* Standard Brands *Case*, 29 U. CHI. L. REV. 339 (1962).

lease a corporate asset. The court relied on *Leader Publishing Co. v. Grant Trust & Savings Co.*[97] In *Leader*, the president, who was the major shareholder of a corporation, leased company property to himself rather than transferring it to the trust company as provided in a mortgage. He also leased in his name the building in which the property was located. The Indiana Supreme Court found his actions potentially or constructively fraudulent as against the interests of the corporation and held that he would be deemed to hold title to the property as trustee.[98] Although *Leader* involved a transaction between the corporation and its president, the *Hartung* court found the principle of the *Leader* case applicable to Hartung's transactions with a third party.[99]

The other actions of Hartung were more serious. The evidence indicated that he contacted clients during the period of corporate turmoil and informed them he would be willing to continue as their architect after withdrawing from the corporation. Some clients subsequently left the corporation. The court applied the well settled principle that a fiduciary cannot lure away business belonging to the corporation.[100] The trial court found that Hartung had persuaded an employee of the firm to join him after he left. This, too, was improper conduct since it is well established that a high level fiduciary can breach his duty by luring away corporate personnel.[101] Hartung also sent letters to twenty of the firm's creditors, which letters announced the demise of the enter-

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[97]182 Ind. 651, 108 N.E. 121 (1915).

[98]The *Leader* court stated that the private interests of corporate officers must yield to their official duties:

> If . . . an officer takes in his own name the title to property conveniently designed for the use of the business of the corporation and occupied by it the law will deem such an act, prima facie, at least, potentially fraudulent as against the corporation and the officer will at the instance of the corporation be held to hold the title as trustee for its use.

Id. at 661, 108 N.E. at 124-25. This was quoted by the *Hartung* court, 301 N.E.2d at 244. For a general discussion of the "corporate opportunity" doctrine, see 3 FLETCHER §§ 861.1 to 867; HENN § 237; LATTIN § 79; Slaughter, *The Corporate Opportunity Doctrine*, 18 Sw. L.J. 96 (1964). Of course, the circumstances must be examined to determine if the opportunity is personal to the individual. Burg v. Horn, 380 F.2d 897 (2d Cir. 1967).

[99]301 N.E.2d at 244. *See also* McKay v. Wahlenmaier, 226 F.2d 35 (D.C. Cir. 1955); Acker, Merrall & Condit Co. v. McGaw, 106 Md. 536, 68 A. 17 (1907); 3 FLETCHER § 861.

[100]The authorities are legion. The court cited Schildberg Rock Prods. Co. v. Brooks, 258 Iowa 759, 140 N.W.2d 132 (1966); Hoggan & Hall & Higgins, Inc. v. Hall, 18 Utah 2d 3, 414 P.2d 89 (1966). See generally note 98 *supra*.

[101]*See, e.g.*, Standard Brands, Inc. v. United States Partition & Packaging Corp., 199 F. Supp. 161 (E.D. Wis. 1961); Duane Jones Co. v. Burke, 306 N.Y. 172, 117 N.E.2d 237 (1954).

prise and were phrased to give the impression that Odle and Burke had been expelled as business associates. In many of the fiduciary obligation cases, such reprehensible conduct aggravates the situation and often is crucial in a determination of liability.[102]

Hartung's third argument failed when the court concluded that the injury caused Odle and Burke was not speculative or conjectural. More specifically, the fees Hartung received from former corporate clients, plus the expenses and inconveniences suffered by Odle and Burke when they vacated the office and terminated the corporate affairs, sustained the award of $17,500.

E. Agency Authority and Joint Ventures

Several agency concepts were involved in the per curiam decision of the Second District Court of Appeals in *Storm v. Marsischke,*[103] which affirmed a judgment of the Marion County Superior Court dismissing the complaint against defendant, McCormick Lumber, at the end of plaintiff's case. The complaint alleged that McCormick Lumber, acting through employee Winters, had become bound on a construction contract between the Storms and the other defendants[104] or at least had entered into a joint venture with them. The contracting parties had been brought together by Winters, who had represented to the Storms that the lumber company would enter into the contract with them. At the time of the signing, however, Winters told the Storms that the lumber company would act only as a supplier and would not be a party to the contract.

Plaintiffs first argued that Winters had actual or apparent authority to negotiate for and bind the company on the construction contract. The court did not discuss the actual authority issue but only made a passing reference to the fact that there was no substantial evidence that Winters was a "general agent." The court also rejected the apparent authority argument because there was no showing that McCormick manifested to them that Winters had the claimed authority.[105] To bind the company on this theory, plaintiffs had the burden of showing that the company had held out Winters as a general agent, or as a special agent clothed with

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[102]*See* Comment, *The Obligation of a High-Level Employee to His Former Employer: The* Standard Brands *Case,* 29 U. Chi. L. Rev. 339 (1962).

[103]304 N.E.2d 840 (Ind. Ct. App. 1974).

[104]A default judgment had been entered prior to trial against Marsischke, Wagner and the Duane Construction Company.

[105]304 N.E.2d at 842. The court cited Kody Eng'r Co. v. Fox & Fox Ins. Agency, Inc., 303 N.E.2d 307 (Ind. Ct. App. 1973); State Life Ins. Co. v. Thiel, 107 Ind. App. 75, 20 N.E.2d 693 (1939). For a general discussion of apparent authority, see Restatement (Second) of Agency §§ 8, 27 (1958); Seavey § 8D.

more authority than actually conferred,[106] and that plaintiffs had reasonably relied on this representation. The key is proof of affirmative action on the part of the principal.[107]

The court concluded there was no substantial evidence that Winters had been clothed with the appearance of authority. He had contacted the Storms when he heard of their plans and introduced them to Marsischke and Wagner; thus the Storms might have thought they were negotiating with the lumber company. The court, in fact, conceded there was a "suspicion" that the lumber company was involved in the project. However, the Storms should have realized that this notion was mistaken when they signed a contract naming the Duane Construction Company as the contractor. Winters' comment that the company "normally conducted its business in this manner"[108] had to be discounted since an agent's statements are irrelevant in establishing his authority.

A second, and somewhat more persuasive argument, was that Winters possessed inherent authority[109] to bind the lumber company. The *Storm* court stated that there was no Indiana case which expressly recognized the principle but noted that *Farm Bureau Mutual Insurance Co. v. Coffin*[110] possibly applied the underlying rationale. The theory was rejected here since the Storms had failed to show that Winters was a general agent.

Plaintiffs' final argument was that it was error not to find the lumber company a partner or joint venturer with the construction company. The premise of this argument was that the president of McCormick Lumber was also a director of a successor corporation to the construction company. The court recognized that the corporate fiction can be disregarded to prevent fraud or injus-

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[106]Farm Bureau Mut. Ins. Co. v. Coffin, 136 Ind. App. 12, 186 N.E.2d 180 (1962).

[107]304 N.E.2d at 843, *quoting from* Pan Am. World Airways, Inc. v. Local Readers Serv., Inc., 143 Ind. App. 370, 377, 240 N.E.2d 552, 556 (1968). *See generally* RESTATEMENT (SECOND) OF AGENCY § 285 (1958); SEAVEY § 75D (1964).

[108]304 N.E.2d at 843.

[109]This concept, which often overlaps with apparent authority, exists apart from any manifestation or holding out by the principal. Rather it rests solely on the agency relationship, *i.e.*, the agent has a certain authority simply by being employed in a capacity that would normally carry the authority contemplated or perceived by the third party. For a general discussion of the principle of inherent agency power, see RESTATEMENT (SECOND) OF AGENCY § 8A (1958); SEAVEY § 59D. The court noted, 304 N.E.2d at 844 n.5, that a special agent has been recognized as possessing inherent agency power but that this issue had not been presented. *See generally* RESTATEMENT (SECOND) OF AGENCY § 161A (1958).

[110]136 Ind. App. 12, 186 N.E.2d 180 (1962).

tice[111] but concluded that a common board alone was insufficient to negate the existence of separate legal entities. The court relied on *Hart, Schaffner & Marx v. Campbell,*[112] in which it was held that, absent fraud or bad faith, the mere fact that the officers of one corporation were the shareholders, directors and officers of another did not justify a conclusion that the independent legal existence of the second corporation should be ignored.

The plaintiffs contended that *Voorhees-Jontz Lumber Co. v. Bezek*[113] supported their argument that a joint venture existed between the lumber company and the construction company. In *Voorhees-Jontz,* the court held that two similar corporations were acting in concert but, in *Storm,* as the court pointed out in distinguishing the case, there was no history of prior practices that would justify a finding that McCormick Lumber was either directly or through authorized agents referring parties to the construction company under the representation that the two worked together.

F. *Notification of Change of Ownership*

Meggs v. Central Supply Co.[114] is another case illustrating the importance of observing legal formalities in conducting business transactions. The suit was brought by a supplier against both the present and former owners of a sole proprietorship to recover for merchandise ordered after the sale of the business. Meggs, the former owner, had some dealings with Central Supply in the past. Meggs did not notify his suppliers of the sale of the business at the time it was sold, although written notice was eventually sent to Central Supply. The Henry County Circuit Court entered a judgment against Meggs for supplies ordered after the business was sold and before the notice was received. The First District Court of Appeals affirmed.[115]

The court did not expressly articulate the theory of liability but apparently used the doctrines of equitable estoppel and fraudulent or negligent misrepresentations.[116] The court relied on general

[111] The court cited Feucht v. Real Silk Hosiery Mills, Inc., 105 Ind. App. 405, 12 N.E.2d 1019 (1938). *See also In re* Clarke's Will, 204 Minn. 574, 578-79, 284 N.W. 876, 878 (1939). For a general discussion of the appropriateness of disregarding the corporate fiction in certain situations, see 1 FLETCHER §§ 41-46; HENN §§ 138, 146-49; LATTIN §§ 11, 13-18.

[112] 110 Ind. App. 312, 320-21, 38 N.E.2d 895, 899 (1942).

[113] 137 Ind. App. 382, 209 N.E.2d 380 (1965).

[114] 307 N.E.2d 288 (Ind. Ct. App. 1974) (Lowdermilk, J.). Although the *Meggs* case involved a sole proprietorship, a similar situation might arise upon the sale of a corporation.

[115] *Id.* at 289. The other defendant, the purchaser Brown, defaulted.

[116] *Id.* at 292. *See generally* J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP § 36 (1968).

authority[117] and an Indiana case, *Elverson v. Leeds*,[118] which had not been discovered by the parties. In *Elverson*, a supplier recovered from the former owner of a greenhouse for supplies ordered in the firm name by the former owner's son who had purchased the business. As in *Meggs*, the suppliers had not been informed of the sale. The *Elverson* court concluded that, between the former owner and her son, there was neither a principal-agency relationship nor a partnership that would have required the retiring partner to notify creditors.[119]

However, the *Elverson* court did analogize to the partnership situation, reasoning that a third party dealing with a business has the right to assume that the supposed owner will be liable for the firm's orders until there is notification to the third party of a change in ownership.[120] The key to liability under *Elverson* is that the new owner must use the firm name with the knowledge, consent and approval of the former owner. This element was satisfied in *Meggs* by the showing that the business name and goodwill of the enterprise were among the assets sold by Meggs. The key to escaping liability under *Elverson* is a showing that the supplier had actual or constructive knowledge of the transfer of the business. Constructive knowledge, for example, from a newspaper disclaimer of liability, might suffice for tradepersons who were familiar with the firm but had no actual dealings with it. However, actual notice is the only sure technique by which a former owner may escape liability to those with whom he has had prior dealings.

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[117]Hendley v. Bittinger, 249 Pa. 193, 94 A. 831 (1915); 52 AM. JUR. *Trademarks* § 38 (1944).

[118]97 Ind. 336 (1884). The court referred to *Elverson* as a "hog" case presumably because the case was discovered while "rooting through the archives." 307 N.E.2d at 290.

[119]The Indiana Uniform Partnership Act, IND. CODE § 23-4-1-35 (Burns 1972), provides that a partner can bind a dissolved partnership to third persons who had neither actual nor constructive notice of the dissolution. *Id.* § 23-4-1-16 provides that a person who permits another to represent him as a partner to third persons is liable to such third persons. See generally J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP §§ 80-82 (1968).

[120]The *Elverson* court pointed out that in either case, whether one is engaged in a partnership or in a business under an assumed name, the result should be the same:

> Third parties are just as likely to lend their credit, and just as likely to be defrauded as though she were a retiring partner; . . . She engages in business under a firm name, which imports a partnership, and the business continues under such name, without any notice that she has ceased her connection with it. Why should she not be treated like such partner, and held to the same obligations?

97 Ind. at 339.

G. Statutory Developments

The 1974 session of the 98th Indiana General Assembly adopted several significant amendments to the Indiana General Corporation Act and to other provisions of the Indiana Code relating to corporate affairs.[121]

1. Class Voting of Shares

The provision of the General Corporation Act specifying the shareholders entitled to vote on proposed amendments to articles of incorporation was revised by deleting subsection (b), which provided that a series of shares of a class would be treated as a separate class for purposes of class voting.[122] This particular subsection has had an unusual legislative career and it is difficult to divine the legislative intent. The provision was not included when Indiana Code section 23-1-4-4 was adopted in its present form in 1967,[123] but the provision was added by the General Assembly in 1969.[124] Thus the recent amendment returned the section to its

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[121]Other acts passed by the General Assembly that deserve noting include: (1) Ind. Pub. L. No. 125 (Feb. 20, 1974), *amending* IND. CODE § 27-8-5-10 (IND. ANN. STAT. § 39-4260, Burns Supp. 1974) (to allow coordination of benefits under group hospital, medical or surgical expense policies); (2) Ind. Pub. L. No. 130 (Feb. 15, 1974), *amending* the Indiana Credit Union Act, IND. CODE §§ 28-7-1-1 *et seq.* (Burns Supp. 1974) (to permit state chartered credit unions to compete more effectively with federal credit unions); (3) Ind. Pub. L. No. 121 (Feb. 14, 1974), *amending* IND. CODE § 27-1-12-2 (IND. ANN. STAT. § 39-4202, Burns Supp. 1974) (to permit the investment of certain insurance company funds in mutual funds); (4) Ind. Pub. L. No. 123 (Feb. 14, 1974), *amending* IND. CODE § 27-1-20-20 (IND. ANN. STAT. § 39-5020, Burns Supp. 1974) (to permit insurance companies to publish financial statements prepared on a basis other than the accounting method required by the Insurance Department); (5) Ind. Pub. L. No. 150 (Feb. 13, 1974), *amending* the Offenses Against Property Act, IND. CODE § 35-17-5-13 (IND. ANN. STAT. § 10-3040, Burns Supp. 1974) (to permit the inference that the owner of property is a corporation); (6) Ind. Pub. L. No. 124 (Feb. 15, 1974), *amending* IND. CODE § 27-4-1-4 (IND. ANN. STAT. § 39-5304, Burns Supp. 1974) (to make it an unfair or deceptive practice for insurance companies to refuse to make payments under health and hospital insurance policies to for-profit medical facilities); (7) Ind. Pub. L. No. 127 (Feb. 15, 1974), *amending* IND. CODE § 28-1-2-2 (Burns Supp. 1974) (to increase the size of the Indiana Department of Financial Institutions in order to admit a representative from state chartered credit unions).

[122]Ind. Pub. L. No. 112 (Feb. 12, 1974), *amending* IND. CODE § 23-1-4-4 (Burns Supp. 1974). The act was deemed an emergency measure and became effective upon passage.

[123]Ch. 275, § 23, [1967] Ind. Acts 811 (codified at IND. CODE § 23-1-4-4 (Burns Supp. 1974)).

[124]Ch. 187, § 11, [1969] Ind. Acts 508 (repealed 1974).

original form, which was derived from the Model Business Corporation Act.[125]

The General Assembly no doubt reasoned that the owners of a series of shares of a class should not have a greater proportional say in passing on amendments than they would have if the shares had been issued as a class. In fact, the former provision made it possible for a small group of shareholders of a company with one class but several series of shares to defeat an amendment overwhelmingly approved by the other owners of the corporation even when the proposed amendment did not have a significant impact on the series shareholders' rights or interests. The possibility of such a veto might well have been the motivation behind deleting subsection (b).

However, the General Assembly may have gone too far. A concern about an unjustified veto power is legitimate, but it is conceivable that an amendment to the articles of incorporation would affect the interests of only one series. In such a case, a veto power might well be appropriate. Although Indiana appears to be the only state that treated a series of a class as a separate class for all votes, the comments to section 60 of the Model Business Corporation Act indicate that several Model Act states provide that a series shall vote as a class when that series, but no other, will be affected by a proposed amendment or when the effect on that series differs from the effect on other series.[126] The comments also indicate that several non-Model Act jurisdictions mandate that a series vote as a class when affected by a proposed amendment.[127] This appears to be an eminently reasonable compromise between the interests of the corporation and the interests of series' owners, and the General Assembly might well consider another change to section 23-1-4-4 in the next session.

2. *Professional Accounting Corporations*

Another significant development in the corporate area was the adoption of the Professional Accounting Corporation Act.[128]

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[125] 2 ABA-ALI MODEL BUS. CORP. ACT ANN. § 60 (1971). *See* Deer & Burns, *The 1967 Amendments to the Indiana General Corporation Act*, 43 IND. L.J. 14, 28 (1967).

[126] 2 ABA-ALI MODEL BUS. CORP. ACT ANN. § 60, comment ¶ 3.02 (1971), indicates that Connecticut, Georgia, Illinois, Virginia and Wisconsin have such a provision.

[127] *Id.* comment ¶ 3.03 indicates that Delaware, Florida, Massachusetts, New Jersey, New York and Oklahoma have different statutory provisions that require a series vote when a series will be affected by a proposed amendment.

[128] Ind. Pub. L. No. 113 (Feb. 18, 1974), *amending* IND. CODE §§ 23-1-13.5-1 to -6 (Burns Supp. 1974). The act took effect on July 1, 1974, under an

Although Indiana has had professional corporation acts for a number of years,[129] the approach of the Accounting Corporation Act differs significantly from the others. It is a totally different statute rather than an adaptation. It is also somewhat less complex than the others.

The Act establishes shareholder qualifications and imposes certain restrictions on the management of accounting corporations. The qualifications and restrictions depend on whether the corporation is a corporation of certified public accountants,[130] a corporation of public accountants[131] or a corporation of accounting practitioners.[132] Unlike the other three professional corporation acts that have specific provisions relating to corporate names,[133] voting trust restrictions,[134] conflicts of interest,[135] annual reports and certifications,[136] and reporting of ownership changes,[137] section 1 of the Accounting Corporation Act simply provides that:

> One or more individual persons may organize a corporation for the practice of public accounting under the general corporation law. The corporation shall not be

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emergency provision. Although there are other benefits deriving from the incorporation of a professional practice, such as unlimited duration and limited liability on non-professional matters, the prime motivation for using the corporate form has been the tax benefits available to corporations and their employees. These benefits traditionally have been unavailable to sole practitioners or partnerships. *See generally* HENN § 77. The legal periodicals are replete with articles discussing tax considerations for professional corporations. *See, e.g.*, Levenfeld, *Professional Corporations and Associations*, 8 HOUSTON L. REV. 47 (1970); Overbeck, *Current Status of Professional Associations and Professional Corporations*, 23 BUS. LAW. 1203 (1968); Strong & Holdsworth, *Incorporating a Professional Practice—A Comprehensive Checklist*, 16 PRAC. LAW. 69 (May, 1970); Weinberg, *A Brief Look at the Advantages and Disadvantages of Professional Incorporation*, 6 CREIGHTON L. REV. 17 (1973). It should be noted that the liberalization of benefits available to self-employed persons under the Keogh Act, 26 U.S.C. §§ 401-04 (1970), has somewhat reduced the drive toward professional incorporation.

[129]IND. CODE §§ 23-1-13-1 to -11 (Burns 1972) (General Professional Corporation Act); *id.* §§ 23-1-14-1 to -21 (Medical Professional Corporation Act); *id.* §§ 23-1-15-1 to -21 (Dental Professional Corporation Act). Attorneys can incorporate under the General Act pursuant to an order of the Indiana Supreme Court effective April 10, 1970. Order in the Matter of Professional Corporations, 253 Ind. xxviii (1970).

[130]IND. CODE § 23-1-13.5-4 (Burns Supp. 1974).

[131]*Id.* § 23-1-13.5-5.

[132]*Id.* § 23-1-13.5-6.

[133]*Id.* §§ 23-1-13-5 (general), -14-7 (medical), -15-7 (dental) (Burns 1972).

[134]*Id.* §§ 23-1-13-8 (general), -14-11 (medical), -15-11 (dental).

[135]*Id.* §§ 23-1-13-11 (general), -14-17 (medical), -15-17 (dental).

[136]*Id.* §§ 23-1-13-11 (general), -14-19 (medical), -15-19 (dental).

[137]*Id.* §§ 23-1-13-11 (general), -14-20 (medical), -15-20 (dental).

> required to have more directors than shareholders, but at least one director shall be a shareholder. The other directors need not, but may, be shareholders.[138]

The Act requires stock purchase agreements to keep shares from nonqualified persons but contains nothing comparable to the detailed stock purchase and valuation provisions of the other acts.[139]

Not surprisingly, the new Act recognizes the role of the Indiana State Board of Public Accountancy in the regulation of the profession. The Act specifically provides that persons associated with accounting corporations who practice within Indiana, as well as the corporations themselves, are subject to the authority of the Board to the same extent as partnerships.[140] Since there might be differences between a partnership practice and a corporate practice, the General Assembly authorized the Board to issue further corporate regulations consistent with or required by the public welfare.[141]

As noted, the requirements for the three types of accounting corporations vary. Common to all is the requirement that the sole purpose and business of the corporation be to furnish services not inconsistent with the accountancy law and the regulations of the Board. However, in a corporation of certified public accountants, the corporate managers and all but one shareholder may be certified public accountants of other states.[142] Here the Act no doubt contemplates nationwide accounting firms. Shareholders and managers actually practicing in the state must be licensed in Indiana.[143] The relevant sections of the Act for public accounting and accounting practitioner corporations require that all persons associated with the corporation be licensed in Indiana.[144]

The Accounting Corporation Act permits foreign accounting corporations to render professional services in Indiana if the services are consistent with the regulations of the Board and if the foreign corporations are registered with the Board.[145] The other

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[138]*Id.* § 23-1-13.5-1 (Burns Supp. 1974). The main requirement is that all shareholders must be licensed accounting professionals.

[139]*Compare id.* §§ 23-1-13.5-4(e), -5(d) *and* -6(d), *with id.* §§ 23-1-14-18 *and* -15-18 (Burns 1972).

[140]*Id.* § 23-1-13.5-3 (Burns Supp. 1974). The Indiana Public Accountancy Law is *id.* §§ 25-2-1-1 to -23.

[141]*Id.* § 23-1-13.5-3 provides that the Board may prescribe regulations concerning the name of the corporation, affiliations with other organizations, and the liability of shareholders.

[142]*Id.* § 23-1-13.5-4(b) to (d).

[143]*Id.* § 23-1-13.5-4(d).

[144]*Id.* §§ 23-1-13.5-5(b) & (c) (public accounting corporation), -6(b) & (c) (accounting practitioner corporation).

[145]*Id.* § 23-1-13.5-2.

professional corporation acts prohibit mergers or consolidations with foreign corporations.[146] The Accounting Corporation Act is silent on this point, but presumably mergers or consolidations are permitted pursuant to the applicable provisions of the General Corporation Act[147] so long as the surviving or new corporation complies with the Act.

3. Not-for-Profit Corporations—Indemnification of Corporate Personnel and Liability Insurance

The General Assembly belatedly recognized that officers and directors of Indiana not-for-profit corporations are as entitled to indemnification for expenses incurred in defending lawsuits as are their counterparts in general corporations or Indiana insurance corporations. The General Assembly also recognized that such corporations should be empowered to purchase and maintain liability insurance for corporate personnel. These recognitions were accomplished by the addition of two new subsections, (b) (9) and (b) (10), to the general powers section of the Indiana Not-For-Profit Corporation Act.[148] The action was belated, however, since the General Corporation Act has had an indemnification provision since 1959[149] and the Indiana Insurance Law has had one since 1973.[150] In addition, corporations under those two acts were authorized to purchase what is commonly called "director and officer" or "D & O" insurance in 1973.[151]

The not-for-profit insurance provision, subsection (b) (10), is identical to the provisions added to the other acts in 1973. However, the not-for-profit indemnification provision, subsection (b) (9), differs from the comparable indemnification section of the General Corporation Act and the reason for this difference is not apparent. It is possible that there was no intent to treat not-for-profit corporations differently. Subsection (b) (9) is the same as the pre-1973 General Corporation Act indemnification provision except that, in subsection (b) (9), indemnification is limited to de-

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[146]*Id.* §§ 23-1-13-10 (general), -14-21 (medical), -15-21 (dental) (Burns 1972).

[147]*Id.* §§ 23-1-11-15, -16.

[148]Ind. Pub. L. No. 114 (Feb. 12, 1974), *amending* IND. CODE § 23-7-1.1-4 (b) (9) & (10) (Burns Supp. 1974).

[149]IND. CODE § 23-1-2-2 (b) (9) (Burns Supp. 1974).

[150]Ind. Pub. L. No. 271 (April 13, 1973), *amending* IND. CODE § 27-1-7-2 (b) (8) (IND. ANN. STAT. § 39-3702 (b) (8), Burns Supp. 1974).

[151]IND. CODE § 23-1-2-2 (b) (10) (Burns Supp. 1974) (General Corporation Act); *id.* § 27-1-7-2 (b) (9) (IND. ANN. STAT. § 39-3702 (b) (9)) (Insurance Law). For a discussion of the 1973 amendments, see Galanti, *Corporations, 1973 Survey of Indiana Law*, 7 IND. L. REV. 77, 103-09 (1973).

fenses of civil actions and does not extend to defenses of criminal actions. Thus, the drafters may have inadvertently, rather than intentionally, used a superseded statutory provision as a model. Whatever the explanation, the inescapable fact is that the indemnification provisions are different.

In fact, the indemnification provision is inconsistent with the insurance provision. The insurance provision refers to "directors, officers, employees or agents" of the corporation, whereas the indemnification provision refers only to "directors or officers." The indemnification provisions of both the General Corporation Act and the Insurance Law authorize indemnification of corporate personnel other than directors and officers.[152] The failure to include these additional corporate personnel in the not-for-profit indemnity provision might, therefore, seem a step backward, but the problem may be more apparent than real. As is common to statutory indemnification provisions,[153] subsection (b) (9) is not exclusive and does not impair rights that might be authorized by provisions in the articles of incorporation, bylaws, or other corporate acts or documents.[154] Presumably, indemnification for employees or agents of a corporation can be authorized by these methods. However, it is possible that a court might strictly construe subsection (b) (9) to

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[152]This is also the position of the drafters of the Model Business Corporation Act. *See* 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5 (1971). The Model Act annotation lists Connecticut, Massachusetts and Minnesota as authorizing indemnification of agents and employees as well as officers and directors. Employees are included in the California, Ohio, Rhode Island, and South Carolina statutes. Connecticut goes still farther and protects the shareholders of a corporation as does North Carolina under some circumstances. *Id.* at 227. The protection accorded employees and agents is apart from whatever protection they enjoy under the general principles of agency law. *See* HENN § 379, at 800 n.2; RESTATEMENT (SECOND) OF AGENCY §§ 439-40 (1958); SEAVEY § 168.

[153]The Model Act indemnification provision is nonexclusive as apparently are the statutes in the majority of jurisdictions. 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5, at 225 (1971). *See* HENN § 380, at 806; LATTIN § 78, at 281 & § 114, at 449-50. *See also* L. RATNER, PROTECTING THE CORPORATE OFFICER AND DIRECTOR FROM LIABILITY (1970); Jervis, *Corporate Agreements to Pay Directors' Expenses in Stockholders Suits*, 40 COLUM. L. REV. 1192 (1940).

[154]*See* HENN §§ 379-80; LATTIN §§ 78, 114. There is authority which cautions against over-reliance on such a provision when the indemnification goes substantially beyond the statute or when it could be characterized as unjust or inequitable. Teren v. Howard, 322 F.2d 949 (9th Cir. 1963). Another risk is that a poorly drafted bylaw or other indemnification provision could be deemed as restricting rather than expanding available indemnification. *See* Essential Enterprises Corp. v. Dorsey Corp., 182 A.2d 647 (Del. Ch. 1962). *See generally* Loftin, *Indemnification of Corporate Executives*, 1 LIABILITIES OF CORPORATE OFFICERS AND DIRECTORS 69 (1968).

preclude such indemnification, thus limiting employees and agents of not-for-profit corporations to the insurance protection authorized by subsection (b) (10).

In contrast with the provisions of the other two acts which permit indemnification of expenses incurred in defending both civil and criminal suits, the not-for-profit provision is limited to civil actions.[155] It is understandable that the General Assembly would not want a corporation to pay fines imposed on a director or officer, but there is no reason why not-for-profit directors or officers, like their for-profit counterparts, should not be indemnified for expenses incurred in successfully defending criminal prosecutions. Of course, the nonexclusive nature of the provision would probably be helpful here.

Subsection (b) (9) limits indemnification to "expenses actually and reasonably incurred . . . in connection" with the defense, while the current General Corporation Act provision only limits indemnification to those expenses "reasonably incurred."[156] Presumably the "actually and reasonably incurred" language was carried over from the pre-1973 General Corporation Act provision[157] and was included because the legislature was concerned that deleting "actually" would encourage a less careful attitude in defending actions. Unfortunately, retaining "actually" might preclude a corporation from making advances to finance a defense or making payments directly to a third party such as an attorney, thus forcing the defendant to pay and then seek reimbursement.[158]

As it did in 1973 when the other two acts were amended, the General Assembly failed to specify whether settlement expenses are covered by subsection (b) (9).[159] Another apparent oversight was the omission of language authorizing indemnification of expenses incurred in defending claims or actions "arising out of a person's

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[155]*Compare* IND. CODE § 23-7-1.1-4(b) (9) (Burns Supp. 1974), *with id.* § 23-1-2-2(b) (9), *and id.* § 27-1-7-2(b) (8) (IND. ANN. STAT. § 39-3702(b) (8)).

[156]*Compare* IND. CODE § 23-7-1.1-4(b)(9) (Burns Supp. 1974), *with id.* § 23-1-2-2(b) (9). *See* Galanti, *supra* note 151, at 106. The Model Act refers to "actually and reasonably." 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5 (1971).

[157]Ch. 24, § 1, [1959] Ind. Acts 73, *as amended*, ch. 187, § 1, [1969] Ind. Acts 491.

[158]*See* Galanti, *supra* note 151, at 106.

[159]*Id.* Some indemnification provisions specifically refer to settlement expenses. *See* 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5(a) (1971); HENN § 380, at 811 nn.46-49. It is, of course, possible that settlement expenses might be expenses "reasonably incurred" in defending a claim and might also be covered in a provision in the articles of incorporation, or the bylaws, or otherwise as authorized by the nonexclusive proviso of IND. CODE § 23-7-1.1-4 (b)(9) (Burns Supp. 1974).

status" as an officer or director.[160] The officers and directors of not-for-profit corporations are limited to claims based on acts done in their official capacities and may not seek indemnity for claims that might arise simply because they are officers or directors.[161]

Similar to the provisions of the other two acts, the indemnification provision is not liberal toward persons who have not been completely successful in defending suits. This contrasts with statutes in some jurisdictions, the Model Business Corporation Act,[162] and even the indemnification provisions of other Indiana statutes.[163] These statutes do permit indemnification for the unsuccessful defendant if he has at least met prescribed standards, such as "acting in good faith and in a manner reasonably believed to be in or not opposed to the best interest of the corporation, and, with respect to any criminal actions or proceeding, had no reasonable cause to believe his conduct was unlawful."[164] To prohibit wrongdoers from seeking indemnification for all unsuccessful defenses, these statutes often adopt various techniques for an independent determination that indemnification is proper. These techniques include advice of independent legal counsel, ratification by disinterested directors or by shareholders, or an order by the court hearing a derivative action.[165]

Subsection (b) (9) permits the indemnification of persons serving as officers or directors of other corporations on behalf of the not-for-profit corporation. However, this indemnification provision applies only to corporate business enterprises and not to partnerships, joint ventures, trusts or other enterprises as permitted

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[160]*See* 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5, at 219-20 (1971).

[161]*See generally* Galanti, *supra* note 151, at 106 n.144; Knepper, *Corporate Indemnification and Liability Insurance for Corporation Officers and Directors*, 25 SW. L.J. 240 (1971). Again, the nonexclusive proviso may be of some help. See note 159 *supra*.

[162]1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5, at 227-28 (1971). *See generally* HENN § 380, at 809-11; Galanti, *supra* note 151, at 107.

[163]See IND. CODE § 28-1-5-2(b) (8) (Burns Supp. 1974), which authorizes commercial banks to indemnify trustees or officers against expenses and amounts paid in settlement in certain actions, and Ind. Pub. L. No. 129 (Feb. 15, 1974), *amending* IND. CODE § 28-6-1-45 (Burns Supp. 1974), which accords similar protection to trustees and officers of savings banks.

[164]1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5(a) & (b), at 214 (1971). *See generally* HENN § 380, at 809-11. This so-called business judgment rule has afforded a great deal of protection against liability for errors and conduct. *See* Freeman v. Hare & Chase, Inc., 16 Del. Ch. 207, 142 A. 793 (1928); *Symposium—Officers' and Directors' Responsibilities and Liabilities*, 27 BUS. LAW. 1 (1972).

[165]For the jurisdictions adopting the various techniques, see 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5, at 231-35 (1971); HENN § 380, at 810 n.38.

under the General Corporation Act.[166] Again, the probable explanation is that pre-1973 statutory language was used as a model. However, the limitation is not significant since not-for-profit corporations are less likely than for-profit corporations to be involved in non-corporate business enterprises. Nonetheless, the General Assembly might well be advised to amend section 23-7-1.4-4 of the Indiana Not-For-Profit Corporation Act to conform to the General Corporation Act and the Insurance Law, for reasons of symmetry and also because officers and directors of not-for-profit corporations should be treated equally with their for-profit or insurance counterparts.

Subsection (b) (10), the insurance provision, is the same as in the General Act and the Insurance Law.[167] The provision is based on the relevant section of the Model Act[168] and authorizes insurance even in those cases when the not-for-profit corporation could not grant indemnification under subsection (b) (9). Conceivably this provision could cause corporate personnel to be less careful in fulfilling their duties to the corporation, but no doubt public policy would preclude insuring against gross negligence, self-dealing, or conduct amounting to total abdication of corporate responsibilities.[169] This assumes, of course, that insurance covering such acts could be found. As Professor Bishop points out in his excellent article on indemnification, insurers are not inclined to develop or retain insurance policies which might serve to increase the risks insured against.[170] The self-interest of insurance companies would assure that "D & O" insurance would not be counter-productive. More likely, a court would limit the provision to situations involving ordinary negligence in the performance of a duty to the corpora-

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[166]IND. CODE § 23-1-2-2(b) (9) (Burns Supp. 1974). See Galanti, *supra* note 151, at 105.

[167]IND. CODE § 23-1-2-2(b) (10) (Burns Supp. 1974) (General Corporation Act); *id.* § 27-1-7-2(b) (9) (IND. ANN. STAT. § 39-3702(b) (9)) (Insurance Law). *See generally* Galanti, *supra* note 151, at 107-09.

[168]1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5(g) (1971).

[169]For a general discussion of liability insurance, see HENN § 380, at 812; Bishop, *Sitting Ducks and Decoy Ducks: New Trends in Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1087 (1968); Knepper, *Corporate Indemnification and Liability Insurance for Corporation Officers and Directors*, 25 SW. L.J. 240 (1971); Kroll, *Some Reflections on Indemnification Provisions and S.E.C. Liability Insurance in the Light of* Barchris *and* Globus, 24 BUS. LAW. 681, 687-92 (1969).

[170]Bishop, *Sitting Ducks and Decoy Ducks: New Trends in Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1094 (1968). For a discussion of the terms of a typical "D & O" policy and an evaluation checklist, see Hinsey & DeLancey, *Directors and Officers Liability Insurance—An Approach to its Evaluation and a Checklist*, 23 BUS. LAW. 869 (1968).

tion. Under this construction, the indemnification insurance provision would be no more harmful to the public interest than is automobile liability insurance.

IV. Civil Procedure and Jurisdiction

*William F. Harvey**

The following survey of Indiana cases is intended as an overview of significant developments in the area of civil procedure and jurisdiction during the judicial term extending from May, 1973, through May, 1974. Because the discussion is synoptic in nature, it does not purport to provide either exhaustive coverage or extensive analysis of the cases.

A. *Jurisdiction and Service of Process*

Indiana's long-arm statute[1] has been the subject of interpretation this past year in the federal courts. In *Valdez v. Ford, Bacon & Davis, Texas, Inc.*,[2] Judge Sharp, in a memorandum opinion, espoused a liberal construction of the scope of Trial Rule 4.4. In reviewing historical precedents and scholarly exegeses of the rule, he found that:

> Indiana Trial Rule 4.4 is intended to extend personal jurisdiction of courts sitting in this State, including this one in this case, to the limits permitted under the due process clause of the Fourteenth Amendment.[3]

The question of the scope of Trial Rule 4.4 arose on the motion of Texas Tank, Inc., one of the defendants, to dismiss under Federal Rule of Civil Procedure 12(b)(2) for lack of jurisdiction over the person. In connection with this motion, Texas Tank asserted that the service of process made upon it by certified mail to its office in Dallas, Texas, was impermissible under Federal Rule of Civil Procedure 4 and could only be allowed by incorporating into the federal rule the service of process procedures of Indiana, particularly Trial Rule 4.4.

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[1] IND. R. TR. P. 4.4.

[2] 62 F.R.D. 7 (N.D. Ind. 1974).

[3] *Id.* at 14.